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INTELLIGENCE BRIEF

INDIA'S CRITICAL SHORTAGE OF FOREIGN EXCHANGE

DIRECTORATE OF INTELLIGENCE
Office of Research and Reports

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INDIA'S CRITICAL SHORTAGE OF FOREIGN EXCHANGE

India's foreign exchange reserves are at an all-time low. At the end of February 1965, total gold and foreign exchange reserves had fallen to \$480 million from \$620 million a year earlier. Because the statutory requirement for currency backing is \$420 million, India has only about \$60 million available for use -- roughly enough to finance about 10 days' imports at the current rate. An immediate threat, however, is posed by the need to repay \$200 million to the International Monetary Fund (IMF), \$75 million of which was due on 31 March 1965. If India receives the additional \$100 million standby credit that it has requested from the IMF, the funds will have to be used principally to service this debt and will not substantially improve reserves.

The decline in reserves was caused by a variety of factors, including: increased commercial imports of foodgrains as a result of reduced PL 480 shipments of surplus wheat from the US because of the dock strike; an increased share of exports destined for rupee-payment countries; a shortage of foreign private investment; and rapidly increasing foreign debt repayment obligations. The immediate likelihood of India's improving its foreign exchange position without external assistance is slight because: (1) the decline is occurring at a time when foreign exchange reserves are normally at their peak as a result of the traditionally high rate of export earnings during the preceding 6-month period (October-March), (2) debt-servicing charges are expected to have increased by about 30 percent in Indian fiscal year 1965 (1 April 1964 - 31 March 1965) and are expected to continue to increase rapidly during fiscal year 1966, and (3) there are no immediate prospects for increasing the inflow of private foreign investment.

It appears that in the short run India's foreign exchange reserves cannot be improved significantly unless foreign debt repayment obligations are further liberalized or unless substantially increased amounts of future foreign aid commitments are designated as "nonproject aid" and thus usable to finance imports required for the maintenance of the Indian economy.

1. Foreign Exchange Reserves

India's foreign exchange reserves include gold holdings of the Government of India plus gold and other foreign exchange assets of the

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Reserve Bank of India (RBI). The government's gold holdings normally are not used to satisfy statutory reserve requirements. Because the usual increase in RBI reserves failed to materialize during the October-March period, however, government gold had to be transferred to RBI reserves to keep them above the statutory minimum of \$420 million (including minimum gold reserves of \$240 million). The transfer of gold to the RBI in January 1964 was the first since the partition of India. Additional transfers of gold in January and February 1965 have amounted to \$33.5 million, and it is estimated that by the end of February the remaining gold holdings of the Government of India amounted to only \$31.6 million. Because the RBI's foreign reserves are now only \$448.8 million -- an excess sufficient to finance only about 5 days' imports -- another transfer of gold from the government appears to be imminent. 1/

During the first few years after partition, India's total foreign exchange reserves remained at a level of about \$1.6 billion to \$1.7 billion. These reserves declined steadily throughout the 1950's but stabilized somewhat during the period 1960-63 at around \$600 million to \$650 million. Since February 1964, when reserves were \$620 million, they have been declining steadily. 2/ Reserves in September 1964 were about \$515 million, roughly \$100 million less than in April 1964. 3/ A seasonal decline during these months is normal, but this decline was almost twice as large as that in the same period of 1963. Although Indian reserves usually are replenished during the period 1 October - 31 March, the decline has continued. Thus the current level is more critical than the level in September 1964 because it occurs on the eve of the seasonal decline in exports.

2. Foreign Trade

India's trade deficit in 1964 increased by about \$45 million to \$871 million, compared with \$826 million in 1963. Exports increased by \$106 million, but imports increased even faster by about \$151 million. Available trade data for 1963 and 1964 are shown in the accompanying table. 4/

Contributing further to the decline in foreign exchange reserves was the fact that about 70 percent of the increase in Indian exports was to Bloc countries, with whom resettlement is made in rupees and therefore brings no free foreign exchange. Accordingly, early this year the Government of India made an important change in the existing export promotion

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India: Estimated Trade
1963-64

Million US \$						
Area	1963			1964		
	Imports	Exports	Balance	Imports	Exports	Balance
Communist countries <u>a/</u>	<u>223.0</u>	<u>191.1</u>	<u>-31.9</u>	N.A. <u>b/</u>	<u>268.8</u>	N.A. <u>b/</u>
USSR	128.0	100.8	-27.2	147.0 <u>b/</u>	157.5	+10.5 <u>b/</u>
Czechoslovakia	33.6	29.4	-4.2	44.1 <u>b/</u>	35.7	-8.4 <u>b/</u>
Poland	16.8	18.9	+2.1	31.5 <u>b/</u>	25.2	-6.3 <u>b/</u>
Other	44.6	42.0	-2.6	N.A. <u>b/</u>	50.4	N.A. <u>b/</u>
Free World	<u>2,250.8</u>	<u>1,456.9</u>	<u>-793.9</u>	N.A.	<u>1,485.2</u>	N.A.
US	848.4	264.6	-583.8	987.0	298.2	-688.8
Other	1,402.4	1,192.3	-210.1	1,638.0 <u>c/</u>	1,187.0	-182.2 <u>c/</u>
Grand total	<u>2,473.8</u>	<u>1,648.0</u>	<u>-825.8</u>	<u>2,625.0</u>	<u>1,754.0</u>	<u>-871.0</u>

- a. Excluding imports under long-term credits.
b. Included in the total for other Free World countries.
c. Also including the total for the Communist countries.

regulations, which formerly provided for the issuance of special import licenses to exporters on the basis of their performance. In the future, import entitlements will not be granted against exports made to "rupee trade account" countries. 5/ It also is hoped that nonessential imports, which already are subject to rigid import licensing controls, will be reduced even further by the recent imposition of an import surcharge of 10 percent.

3. Foreign Capital

Net inflow of private capital into India during recent years has been negative -- an average of about \$10 million more in private capital funds left the country each year than came in. This outflow has contributed to the decline in foreign exchange reserves. Although immediate substantial increases in private investment inflow are doubtful, the Government of India recently has shown a willingness to discuss investment opportunities in industry with private investors, and prospects are fairly good for some investment inflow, especially in fertilizer, petrochemical, and possibly steel projects. Project-oriented investments of this type offer only long-term prospects for improving India's foreign exchange position. In the short run, increased investment inflow, earmarked for specific industrial projects, will not provide India with the foreign exchange it currently needs to purchase maintenance goods and equipment to keep existing industrial and agricultural sectors of the economy operating at peak levels.

In the past, India's shortages of foreign exchange have been covered primarily from a net inflow of official foreign capital. In 1964 the Aid-India Consortium pledged \$1,028 million, and in late 1964 the US agreed to provide India with an additional \$400 million in surplus agricultural products. Also in 1964, because of India's shortage of raw materials and difficult foreign exchange position, the US included for the first time \$275 million in aid of the nonproject type in its \$435 million pledge to India through the Aid-India Consortium. To help avert a possible financial crisis, India has requested further such contributions from the Consortium, which is now considering its 1965 aid commitment to India.

Thus far during India's Third Five Year Plan (1 April 1961 - 31 March 1966) the Free World has extended India some \$6.6 billion in aid (including PL 480), and the Bloc has extended some \$1.1 billion. India's annual obligation to service this debt (principal and interest) is increasing. It is estimated that the debt-servicing charge amounted

to \$275 million in Indian fiscal year 1964 and will have increased (based on the debt outstanding as of 10 October 1964) about 30 percent to an estimated total of \$358 million in fiscal year 1965. Future debt-servicing requirements are expected to exert an increasingly greater strain on Indian foreign exchange reserves. To service the present debt an additional \$700 million will be required during the Fourth Five Year Plan (1 April 1966 - 31 March 1971), and if India continues borrowing abroad on the same scale and pattern as in recent years, service payments during the Fourth Five Year Plan are likely to be on the order of \$2.5 billion to \$3.0 billion. If Consortium aid continues at about present levels, roughly 50 percent of it will be needed to service India's external debt.

Sources:

1. State, New Delhi. Airgram A-924, 5 Mar 65. OFF USE.
State, Bombay. T-356, 29 Jan 65. OFF USE.
2. State, New Delhi. Airgram A-1134, 8 May 64. U.
3. Ibid., A-482, 18 Nov 64. U.
4. New Delhi. Eastern Economist, 19 Feb 65, p. 396-397. U.
5. State, New Delhi. Airgram A-878, 23 Feb 65. C.

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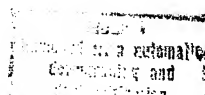
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